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No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

UTILITY CONSULTING SERVICES, INC.,
Appellant,

v.

CITY OF SAN JUAN,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF PUERTO RICO

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. Does Section 1210 of the Puerto Rico Civil Code deprive a party to a municipal contract of property without due process of law when interpreted and applied to permit the municipality to disavow its obligation to pay for services actually rendered and benefits actually conferred under a lawful contingent fee contract?

2. Does the Impairment of Contracts Clause of Article I, Section 10, of the Constitution apply to Puerto Rico and, if so, does Section 1210 of the Puerto Rico Civil Code unconstitutionally impair the obligation of contracts when interpreted to allow courts to eliminate financial obligations under pre-existing and concededly valid contingent fee contracts, even though the other party has rendered full performance?*

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*In accordance with Supreme Court Rule 28.1, counsel certifies that appellant Utility Consulting Services, Inc. has no parent, subsidiaries, or other affiliated companies.

In accordance with Supreme Court Rule 28.4(c), appellant notes that, because the constitutionality of a statute of Puerto Rico is drawn into question in a case in which Puerto Rico itself is not a party, 28 U.S.C. § 2403(b) may be applicable, and appellant is, therefore, serving this Jurisdictional Statement upon the Secretary of Justice of Puerto Rico. *See* Supreme Court Rule 54.

In the Puerto Rico Supreme Court, Utility Consulting Services was the appellee and the City of San Juan and Dr. Hernán Padilla, Mayor of San Juan, were the appellants. No other parties or *amici* participated in the proceedings below.

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ON APPEAL FROM THE SUPREME
COURT OF PUERTO RICO

JURISDICTIONAL STATEMENT

Appellant requests that the Court accept jurisdiction of this appeal and reverse the judgment below.

OPINIONS BELOW

The decision of the Superior Court of Puerto Rico finding that the City of San Juan owed appellant Utility Consulting Services, Inc. over $2.5 million for services rendered (App. B) is unreported. The opinion of the Supreme Court of Puerto Rico reversing that judgment and the dissenting opinion of Justice Rebollo Lopez (App. A) are also unreported.

JURISDICTION

This case began as an ordinary breach of contract suit but, because of the tack taken by the Supreme Court of

Puerto Rico in reversing the trial court, it now presents important federal constitutional issues that this Court has jurisdiction to review on appeal under 28 U.S.C. § 1258(2).

This case arises out of a dispute between appellant Utility Consulting Services, Inc. ("UCS") and the City of San Juan over the City's obligation to honor the terms of a consulting contract that measures UCS's fee by the size of the financial savings actually created by its services to the City. The contract provides that UCS would receive 50% of the amounts saved or recovered by the City. After UCS performed and the City refused to pay what it owed, UCS sued for breach of contract. The City counterclaimed for return of the partial payments it had made, contending that the contract was null and void. After a trial, the Superior Court ruled that the contract was valid in all respects and that the City, which had saved or recovered more than $5 million as a direct result of UCS's services, owed UCS 50% of that amount, as stipulated in the contract. (App. B)

The City appealed to the Puerto Rico Supreme Court, where it continued to urge that the contract was null and void because it allegedly did not comply with various statutory requirements governing municipal contracts and because the City's consent was allegedly induced by fraud. The Puerto Rico Supreme Court reversed, but did not hold that the contract was void, and did not adopt any of the City's other theories. Rather, the court invoked a different statutory provision, Section 1210 of the Puerto Rico Civil Code, 31 L.P.R.A. § 3375. The court decided that the statute gives a court the power and the duty to modify a contract if the court believes that the effort expended by one party does not justify the compensation upon which the parties agreed. Although the statutory language does not refer to any such power, the court, over a dissent, applied this newly fashioned principle to allow

the City to repudiate its financial obligations under the contract. (App. A)

UCS filed two timely motions for reconsideration, arguing in one that this interpretation of Section 1210 was unsound and contending in the other that this construction and application of Section 1210 violated the United States Constitution by depriving UCS of property without due process of law and by impairing the obligations of UCS's contract in violation in Article I, Section 10 of the Constitution. After having denied the petition raising the local law issues on March 19, 1984, the Puerto Rico Supreme Court, on May 3, 1984, over a dissent, denied the motion for reconsideration that raised the federal constitutional objections. (App. C)

In this case, "the question respecting the validity of the statute as applied by the lower court first arose from its unanticipated act in giving the statute a new construction which threatened rights under the Constitution." *Herndon v. Georgia*, 295 U.S. 441, 443-44 (1935). Before the Puerto Rico Supreme Court's decision, the City had never argued that Section 1210 allowed the courts to modify the terms of the contract at issue. Instead, the City had been arguing that the contract was void for various reasons. Even though the Puerto Rico Supreme Court did not dispute the trial court's findings that the contract was valid and that the parties had freely entered into it without fraud or any other improper conduct, the court decided that Section 1210 empowered it to release the City from the obligation to pay for the services rendered at the rate stipulated in the contract. Under these circumstances, there is "no doubt that the federal claim"—that Section 1210 as so interpreted and applied violates the United States Constitution—was raised in a timely fashion because "the ruling of the state court could not have been anticipated and a petition for rehearing presented the first opportunity for raising it." *Herndon v. Georgia, supra*, 295

U.S. at 443-44; *accord Great Northern Railway Co. v. Sunburst Oil & Refining Co.*, 287 U.S. 358, 367 (1932); *Brinkerhoff-Faris Trust & Savings Co. v. Hill*, 281 U.S. 673, 677-78 (1930); *Saunders v. Shaw*, 244 U.S. 317, 319-20 (1917).

Since the petition for reconsideration timely called into question the constitutionality of the statute as construed and applied, the Court has jurisdiction under 28 U.S.C. § 1258(2) to review the decision by way of appeal. *See* R. Stern, E. Gressman, SUPREME COURT PRACTICE § 3.27 at 220-21 (5th ed. 1978); *see, e.g., Torres v. Puerto Rico*, 442 U.S. 465, 468 (1979). On June 29, 1984, UCS filed with the Puerto Rico Supreme Court a notice of appeal to this Court (App. D), and also filed a copy of that notice in the Superior Court, where the record of the case is now located.

STATUTE INVOLVED

Section 1210 of the Civil Code of Puerto Rico, 31 L.P.R.A. § 3375, provides:

> "Contracts are perfected by mere consent, and from that time they are binding, not only with regard to the fulfillment of what has been expressly stipulated, but also with regard to all the consequences which, according to their character, are in accordance with good faith, use, and law."

STATEMENT

1. UCS provides advice and other consulting services to improve its clients' efficient use of electric power, gas, and other similar utility services and products. In January 1973, UCS entered into contract negotiations with the City of San Juan, and in July 1973 a contract engaging the services of UCS was approved by various city officials, including the City's legal counsel, and was signed by the

Mayor. That contract provided for a "contingent fee" method of payment. The City was to pay UCS only if UCS actually effectuated cost savings. If UCS was unable to save the City any money, it would receive nothing. If UCS was able to advise the City on how to save money in the future or to obtain refunds for past utility purchases, the City was to pay UCS 50% of the amount of money UCS saved or recovered for the City.

Until October 1977, the City met its obligations under this contract and paid UCS approximately $232,000 on account of savings achieved. From October 1977 until the contract was cancelled in August 1978, UCS provided additional services by which the City saved or recouped over $5 million more, but the City refused to make any further payments.

2. UCS then filed a breach of contract suit in the Puerto Rico Superior Court. The City responded that the contract was void on various grounds and it counterclaimed for the $232,000 that it had paid to UCS. After trial, the court found that the parties had freely and intelligently entered into a valid contract which called for the City to pay 50% of any savings or refunds that the City enjoyed due to UCS's efforts, that UCS had carried out its end of the contract, that before the City cancelled the contract, UCS's services had created savings and refunds of approximately $5.5 million, but that the City had paid UCS only about $232,000. (App. 2b-7b) Accordingly, the court entered judgment awarding UCS approximately $2.5 million. (App. 8b)

3. On appeal, the Puerto Rico Supreme Court reversed. The court invoked Section 1210 of the Puerto Rico Civil Code, 31 L.P.R.A. § 3375, which states that contracts are binding not only in their express terms but also "with regard to all the consequences which, according to their character, are in accordance with good faith, use, and the law." The court decided that this statutory language

empowers a court to "revise" a contract so as to allow the "partial substitution of the private will by the state will." (App. 3a-4a)

Without impugning either the fairness of the negotiations or the validity of the contract itself, the court held that the allegedly "simple and sporadic work" performed by UCS which resulted in the savings of nearly $5.5 million did not, in the court's view, deserve the compensation provided for in the contract. (App. 2a) The general principle of "liberty of contract" must give way under these circumstances, according to the court, to an "intermediate concept between . . . validity and nullity." (App. 3a) The court ruled that this "intermediate concept" justified its dismissal of both the complaint and the counterclaim, leaving UCS with only the $232,000 it had previously collected out of the $2.7 million that the City owed under the contract. (App. 4a)

Underscoring the surprising nature of the majority's analysis, the dissenting opinion pointed out that the court's decision directly contradicted the principles established by its earlier opinions that (1) contingent fee contracts are perfectly proper and will be respected by the courts and (2) municipalities are bound to honor their contracts and cannot benefit from agreements while at the same time evading their obligations. (App. 6a-8a) In this case, as the dissent noted, the City's own legal counsel had prepared the contract; a "strong" party had not imposed the contractual terms on a "weak" party; the contract itself was not "ultra vires" or contrary to law in any respect; and the City's financial obligation was clearly foreseeable: there was a direct relationship between the benefit conferred and the fee earned, with UCS assuming all the risks of that contingency. (App. 15a) The dissent concluded by asking rhetorically:

> "Is it reasonable for the City to so benefit [by gaining over $5 million in savings] without

> having to pay that [which it] agreed to? . . . Isn't it contrary to equity in the civil sense of the word, that the City may benefit from an agreement in the specific circumstances of this case and also to evade all responsibility in regard to that freely agreed to by it?" (App. 18a-19a)

Thereafter, the court denied UCS's two timely motions for reconsideration, with the same Justice dissenting. (App. C)

THE QUESTIONS ARE SUBSTANTIAL

Under the decision below, governments may simply walk away from their freely undertaken contractual obligations after the other party has performed. By authorizing courts to rewrite the terms of municipal contracts after the private party has performed, the decision licenses municipalities to save money by renouncing their contractual obligations. No proposition strikes more directly at government's obligation to deal fairly with its citizens.

The governmental action endorsed in this case violates two clauses of the Constitution. First, it deprives UCS of property—its contractual entitlement to $2.5 million in fees—without due process of law. Second, the legal principle that the decision below found in Section 1210 substantially impairs the obligations of pre-existing contracts. Since the impairment is not necessary to any important government purpose, it violates the Contract Clause. In sum, the Puerto Rico Supreme Court's decision and the municipal behavior that it approved and encouraged violate "a simple constitutional principle: *government must keep its word.*" L. Tribe, AMERICAN CONSTITUTIONAL LAW § 9-7 at 470 (1978) (emphasis in original).

I. THE DECISION BELOW DEPRIVES UCS OF PROPERTY WITHOUT DUE PROCESS OF LAW.

The constitutional guarantee of due process applies with full force to Puerto Rico as if it were a State of the Union. *Rivera-Rodriquez v. Popular Democratic Party,* 457 U.S. 1, 7 (1982). UCS's interest in its contract with the City of San Juan is "property" within the meaning of the Due Process Clause. "Valid contracts are property, whether the obligor be a private individual, a municipality, a State or the United States." *Lynch v. United States,* 292 U.S. 571, 579 (1934); *accord United States Trust Co. v. New Jersey,* 431 U.S. 1, 19 n.16 (1977) (hereafter "*U.S. Trust*"). Here, the City has deprived UCS of that property by refusing to make good on its $2.5 million obligation. The Puerto Rico Supreme Court has endorsed that deprivation. Under any view of the Due Process Clause, UCS's constitutional rights have been violated.

A. The Due Process Clause Prohibits Government Repudiation Of Its Contracts.

This Court has established that government cannot simply "disregard [its] obligations . . . at its discretion" without running afoul of the Due Process Clause. *Perry v. United States,* 294 U.S. 330, 350 (1935). All governmental entities—federal, state, and local—are bound by their commitments under contracts. *See id., quoting Sinking Fund Cases,* 99 U.S. 700, 719 (1879). Governments may not disavow their contracts except in very limited circumstances; "the due process clause prohibits" the government "from annulling them, unless, indeed, the action taken falls within the . . . police power or some other paramount power." *Lynch v. United States, supra,* 292 U.S. at 579; *see also San Diego Gas & Electric Co. v. San Diego,* 450 U.S. 621, 656 n.23 (1981) (Brennan, J., dissenting) (if government action that deprives someone

of property does not further "the public health, safety, morals, or general welfare," the injured party has a claim under the Due Process Clause).

The government cannot ignore its contractual obligations simply to save money. As Justice Brandeis's opinion for a unanimous Court put it in *Lynch, supra,* 292 U.S. at 580: "To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an act of repudiation." Even when the need for economy "had become urgent," as this Court acknowledged it had during the Great Depression, the government could "reduce gratuities deemed excessive," but the Due Process Clause prohibited it from refusing to pay contractual obligations. *Id.* Simply put, "a State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote" some other notion of the public good "rather than the private welfare of its creditors." *U.S. Trust, supra,* 431 U.S. at 29.

In *United States v. Bethlehem Steel Corp.,* 315 U.S. 289 (1942), the Court confronted and rejected an excuse similar to the one adopted by the court below when it allowed the City of San Juan to renege on its contract. In *Bethlehem Steel,* the government attempted to repudiate its obligations under World War I shipbuilding contracts in which it had promised to pay the contractor one-half of the savings if the actual cost of performance under cost-plus contracts was less than the estimated cost. The government asserted that this premium fee set by the contracts was too high, yielded "unconscionable" profits, and had been forced on the government by the exigencies of war. Rebuffing those pleas, the Court noted in terms that parallel the findings of the trial court here:

> "the contracts resulted from negotiations in which both parties were represented by intel-

> ligent, well-informed and experienced officers whose sole object was to make the best trade possible, under conditions which included . . . contingencies, the results from which were not and could not have been known at the time the contracts were made." 315 U.S. at 301.

Under these circumstances, this Court concluded,

> "We believe the question of whether or not this policy [of allowing the contingent-fee contracts] was wise is outside our province to decide. Under our form of government we do not have the power to nullify it. as we believe we should necessarily be doing, were we to declare these contracts unenforceable on the ground that the profits . . . were too high." *Id.* at 308.

By its interpretation and application of Section 1210 of the Civil Code, the Puerto Rico Supreme Court has allowed the City to nullify a similar government contract after the private party had performed. All that the statute purports to do, however, is to confirm the enforceability of contracts according to what is "expressly stipulated" and to commit the parties *in addition* to other obligations implied by "good faith, use, and law." The statute says nothing about any power to eliminate a term that has been expressly stipulated, such as the term specifying the basis for payment.

Here the court did not find that the terms of the contract were coerced or that the City was under duress of any kind—let alone duress equivalent to the exigencies of war. Neither the court nor the City premised the repudiation on the "police power" or other "paramount" power. Under the Due Process Clause, therefore, the statute may not constitutionally be interpreted and applied to allow the City to renounce its obligation to pay what it agreed to pay for the services actually rendered.

B. Contract Clause Decisions Confirm That The City's Actions Violate The Due Process Clause.

As this Court recognized in *Thorpe v. Housing Authority,* 393 U.S. 268 (1969), the government violates the Due Process Clause when its disavowal of its own contracts would violate the substantive standards of the Contracts Clause. *See* 393 U.S. at 278-79 & nn.31 & 32; *see also Peick v. Pension Benefit Guaranty Corp.,* 724 F.2d 1247, 1264-65 (7th Cir. 1983); *Northwestern National Life Insurance Co. v. Tahoe Regional Planning Agency,* 632 F.2d 104, 106 (9th Cir. 1980).[1] In applying the Contract Clause standards, this Court must decide independently as federal questions whether a particular relationship qualifies for constitutional protection, whether the state statute has been properly interpreted to impair the contract, and whether the State's reasons for abrogating the obligation—because of alleged "unconscionability," excessiveness, or otherwise—satisfy the constitutional standards. *Irving Trust Co. v. Day,* 314 U.S. 556, 561-62 (1942); *State ex rel. Dyers v. Sims,* 341 U.S. 22, 29 (1951); *Coombes v. Getz,* 285 U.S. 434, 441 (1932); *Larson v. South Dakota,* 278 U.S. 429, 433 (1929). The application of Section 1210 of the Puerto Rico Civil Code to permit the City of San Juan to avoid its contract offends Contract Clause standards and for this additional reason denies UCS its right to due process of law.

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[1] In *Thorpe,* the Court applied the Contract Clause standards to the Federal Government, which is not directly subject to that Clause, in order to determine if it had violated the Due Process Clause by allegedly impairing rights arising under its own contract. In contrast, when the Federal Government enacts economic legislation that merely impacts upon contractual relationships between third parties, the Due Process Clause imposes "less searching standards" than the "limitations imposed on states by the Contract Clause." *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.,* ____ U.S. ____, ____, 52 U.S.L.W. 4810, 4814 (June 18, 1984); *see U.S. Trust, supra,* 431 U.S. at 26 n.25 (discussing the "dual standard" for review under the Due Process Clause which turns on whether government action alters contracts between third parties or repudiates its own obligations).

The Contract Clause limits a State's power to modify its own contracts. *Fletcher v. Peck,* 6 Cranch 87, 137-38 (1810). When a government is accused of impairing its own contracts, this Court has applied a two-part test. First, if the contract requires the government to "surrender[ ] an essential attribute of its sovereignty," there is no violation, because the contract is "invalid ab initio." *U.S. Trust, supra,* 431 U.S. at 23. Second, if the contract is not void, an impairment can only be justified "if it is reasonable and necessary to serve an important public purpose." *Id.* at 25. Moreover, because "the State's self-interest is at stake," "complete deference" to the State's own "assessment of reasonableness and necessity is not appropriate." *Id.* at 26; *see also Allied Structural Steel Co. v. Spannaus,* 438 U.S. 234, 244 n.15 (1978) (state impairment of its own contracts receives "more stringent examination" than state actions affecting "contractual relationships between private parties"). In addition, "the severity of the impairment measures the height of the hurdle the State must clear." *Id.* at 245.[2]

The City's behavior, endorsed by the decision below, fails this test miserably. The contract did not compromise the City's governmental powers in any way. The City's promise to pay for consulting services aimed at reducing its utility bills was purely financial and was not "a compromise of the State's reserved powers." *U.S. Trust, supra,* 431 U.S. at 25. As in the case of the debt contracts at issue in *U.S. Trust,* the government simply entered into ordinary contractual obligations to pay money. Once UCS had performed, the City's obligation in fact was identical

[2] A justification for government action that might otherwise be considered reasonable will not be sufficient when the action impairs its own contractual obligations. *See Perry v. United States, supra,* 294 U.S. at 350-51; *Atchison, Topeka and Santa Fe Railway Co. v. National Railroad Passenger Corp.,* 723 F.2d 1298, 1302-03 (7th Cir. 1983).

to a debt contract—an agreement to pay money owed. Under these circumstances:

> " 'Their contracts have the same meaning as that of similar contracts between private persons. Hence, instead of there being in the undertaking of a State or city to pay, a reservation of a sovereign right to withhold payment, the contract should be regarded as an assurance that such a right will not be exercised. A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity.' " *U.S. Trust, supra,* 431 U.S. at 25 n.23, *quoting Murray v. Charleston,* 96 U.S. 432, 445 (1878).

Neither the City nor the Puerto Rico Supreme Court offered any adequate justification for repudiating the contract. In *U.S. Trust,* the States had sought to escape their obligations in order "to serve the admittedly important purposes" of aiding mass transit, 431 U.S. at 29, but this Court held that justification insufficient. Here, the City has not pointed to *any* specific public purpose to justify its repudiation. Except for saving public money, the court below did not even suggest any "public purpose." Simply saving public money, however, is not enough:

> "A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important

public purpose, the Contract Clause would provide no protection at all." *Id.* at 26.[3]

The City's actions here, moreover, did not, as in *U.S. Trust,* merely alter a collateral covenant designed to protect creditors' interests; the City directly abrogated UCS's core contractual right to be paid. UCS became entitled to its stipulated fee once its efforts actually produced the savings and refunds. A statute that allows the Puerto Rico courts to validate the City's renunciation of its matured debt offends the Contract Clause standards that are incorporated into the Due Process Clause when a governmental entity disavows its own contracts.

C. Section 1210, As Interpreted By The Court Below, Deprives UCS Of Any Real Remedy For Its Loss Of Property.

The State must provide an adequate remedy for deprivations of property. *See Hudson v. Palmer,* ___ U.S. ___, ___, 52 U.S.L.W. 5052, 5056-57 (July 3, 1984); *Parratt v. Taylor,* 451 U.S. 527, 542 (1981). If, instead, "the state system itself . . . destroys a complainant's property interest, by operation of law . . . ," then the plaintiff is deprived of his right to procedural due process. *See Logan v. Zimmerman Brush Co.,* 455 U.S. 422, 436 (1982). Similarly, the State may not deprive a person of his property rights for a reason that is so inadequate or improper as to amount to arbitrary and capricious conduct. *Martinez v. California,* 444 U.S. 277,

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[3] Even the dissenting opinion in *U.S. Trust* agreed:

"Beyond dispute, the Contract Clause has come to prohibit a State from embarking on a policy motivated by a simple desire to escape its financial obligations or to injure others through 'the repudiation of debts or the destruction of contracts or the denial of means to enforce them'." 431 U.S. at 52, *quoting Home Building & Loan Ass'n v. Blaisdell,* 290 U.S. 398, 439 (1934).

Similarly, the dissenters agreed that the "Constitution properly prohibits . . . all States from disadvantaging their creditors without reasonable justification or in a spirit of oppression . . . . " 431 U.S. at 53.

282 (1980); *Slochower v. Board of Higher Education*, 350 U.S. 551, 556, 559 (1956); *Parratt v. Taylor, supra*, 451 U.S. at 545 (Blackmun, J., concurring), 552-53 & nn.10 & 12 (Powell, J., concurring).

The decision below cuts off UCS's "state" law remedy for deprivation of its contract rights. It establishes a system under which neither UCS nor any other contracting party can enforce certain municipal contractual obligations. The cities may renounce contractual obligations that they consider improvident in hindsight, secure in the notion that the courts may rewrite the contract rather than remedy the breach. UCS's property rights in the contract and in its ability to enforce contractual obligations are snuffed out as irrevocably as if UCS had been barred at the courthouse door through no fault of its own. The Puerto Rico Supreme Court's refusal to enforce UCS's contract rights leaves UCS without a remedy and endorses the most arbitrary of government actions. It therefore deprives UCS of due process of law. *Logan v. Zimmerman Brush Co., supra*, 455 U.S. at 437.[4]

II. THE STATUTE AS CONSTRUED AND APPLIED VIOLATES THE CONTRACT CLAUSE ITSELF.

A. The Contract Clause Should Apply To Puerto Rico.

The States' attempts to repudiate their debts provided a major impetus to replace the Articles of Confederation

[4] UCS never had a real opportunity even to address whether the payments provided for by the contract were "unfair." The Puerto Rico Supreme Court raised the issue *sua sponte* and decided it without any briefing, argument, or factual presentation addressed to that question. Thus, "the decision made an unsolicited and unexpected gift" to the City of UCS's property interest. *Robinson v. Ariyoshi*, 441 F. Supp. 559, 585 (D. Haw. 1977). The court denied UCS an opportunity for a rehearing to demonstrate why the contract terms were not unfair. That denial of "some real opportunity" to protect its interests itself violated UCS's due process rights. *See Parratt v. Taylor, supra*, 451 U.S. at 542; *Brinkerhoff-Faris Trust & Savings Co. v. Hill, supra*, 281 U.S. at 681-82; *Robinson v. Ariyoshi, supra*, 441 F. Supp. at 580.

with a new Constitution. *See* C. Jacobs, THE ELEVENTH AMENDMENT AND SOVEREIGN IMMUNITY 8-9, 15, 22, 24, 30 (1973). The drafters of the Constitution included the Contract Clause because they feared that States would abrogate valid debts. Hale, *The Supreme Court and the Contract Clause,* 57 Harv. L. Rev. 512, 512-13 (1944). This Court has consistently reaffirmed that the Contract Clause prohibits a State from walking away from contractual obligations that it no longer believes are in its best interests. In referring to parties who entered contracts with governmental units, the Court has observed: "It would be a novel and startling doctrine to all these classes of persons if the Government might discard them at pleasure . . . ." *Hall v. Wisconsin,* 103 U.S. 5, 10 (1880); *accord Indiana ex rel. Anderson v. Brand,* 303 U.S. 95 (1938).

The Court has not previously been called upon to decide whether the Contract Clause of Article I, Section 10, which literally governs the States, also applies to Puerto Rico, either directly or through the Fourteenth Amendment. As the Court explained in *Torres v. Puerto Rico, supra,* 442 U.S. at 470, "Congress generally has left to this Court the question of what constitutional guarantees apply to Puerto Rico." In a series of decisions, this Court has held that various basic constitutional limitations on governmental power apply to Puerto Rico, either directly or through the Fourteenth Amendment. *See, e.g., Rivera-Rodriguez v. Popular Democratic Party, supra,* 457 U.S. at 7 (and cases cited) (First Amendment, equal protection, and due process); *Torres v. Puerto Rico, supra,* 442 U.S. at 469-70 (Fourth Amendment). As another of the "fundamental protections of the United States Constitution," *Rivera-Rodriguez, supra,* 457 U.S. at 7, the Contract Clause of Article I should apply to Puerto Rico in

its present status. The Court should take this opportunity to settle this important issue.[5]

B. The Contract Clause Is Violated.

Under the standards set by this Court for applying the Contract Clause to attempts by States to repudiate their contracts, the City's action here, endorsed by the Puerto Rico courts, does not bear scrutiny. *See,* pp. 12-14, *supra.* Even under the more lenient scrutiny applied to State interference with contracts between third parties, the Contract Clause prohibits State action where a contracting party has "relied heavily, and reasonably, on [a] legitimate contractual expectation," the governmental action focuses on a "narrow class" rather than "a broad societal interest," it "substantially" and "grossly" distorts the contractual agreement, and it works "a severe, permanent, and immediate change" in a contractual relationship "irrevocably and retroactively." *Allied Structural Steel Co. v. Spannaus, supra,* 438 U.S. at 246, 249, 250. In sum, the Contract Clause provides "a protection given to those who invested money, time and effort against loss of their investment through explicit repudiation." *Local Division 589, Amalgamated Transit Union, AFL-CIO, CLC v. Massachusetts,* 666 F.2d 618, 642 (1st Cir. 1981), *cert. denied,* 457 U.S. 1117 (1982).

All these factors are present in this case. The Puerto Rico Supreme Court permitted the impairment by using Section 1210 of the Civil Code as a vehicle to excise a critical obligation from the contract: the obligation to pay the fee stipulated before UCS undertook to perform its part of the bargain. The decision thereby severely and grossly distorted a crucial element of the contract, upon which UCS relied heavily, and does not serve any broad

[5] In *Downes v. Bidwell,* 182 U.S. 244, 263 (1901), a plurality opinion suggested that the Compact Clause of Article I, Section 10, which prevents "States" from entering into agreements with other States or foreign powers, would have applied to Puerto Rico in its original territorial status.

societal interest, but punishes a narrow class of municipal creditors.

We recognize that this Court held in the early part of this century that court decisions, standing alone, cannot be attacked as violating the Contract Clause. *See, e.g., Tidal Oil Co. v. Flanagan,* 263 U.S. 444 (1924); *Cross Lake Shooting and Fishing Club v. Louisiana,* 224 U.S. 632, 638 (1912). In the intervening years, however, this Court has come to recognize in a variety of other contexts that the application of legal principles should not turn on the identity of the branch that is acting but on a functional analysis of the action and of the principles at stake. For instance, in *Supreme Court v. Consumers Union,* 446 U.S. 719 (1980), the Court considered whether the Virginia Supreme Court Justices were immune from suit for injunctive relief. The Court determined that the kind of immunity that judges may claim turns on the nature of the actions challenged, which may be quasi-legislative or quasi-prosecutorial. *Id.* at 734-36; *see Pulliam v. Allen,* ___ U.S. ___, 80 L.Ed.2d 565 (1984); *see also Hutchinson v. Proxmire,* 443 U.S. 111 (1979) (scope of "legislative" immunity); *Doe v. McMillan,* 412 U.S. 306 (1973) (same); *Gravel v. United States,* 408 U.S. 606 (1972) (same).

Similarly, in applying the "state action" exemption from federal antitrust laws, *see Parker v. Brown,* 317 U.S. 341 (1943), this Court has extended the exemption to certain kinds of judicial action when the courts are performing a function that is similar to that of a legislature, to which the doctrine originally applied. *See Hoover v. Ronwin,* ___ U.S. ___, ___, 80 L.Ed.2d 590, 599 (1984); *Goldfarb v. Virginia State Bar,* 421 U.S. 773, 790 (1975). The Court also has decided to use essentially the same standards in determining whether to apply a change in the law retrospectively, even if the law is being changed by judicial decision rather than by legislative action.

Compare Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) (judicial change), *with Bradley v. Richmond School Board*, 416 U.S. 696 (1974) (legislative change). It has long been settled, in addition, that the same concepts of due process constrain government action, whether government is acting through the executive, legislative, *or* judicial branch. *See, e.g., Brinkerhoff-Faris Trust & Savings Co. v. Hill, supra*, 281 U.S. at 680.

This same mode of analysis should lead the Court to abandon the more mechanical approach reflected in cases like *Tidal Oil, supra*. New judicial decisions may just as effectively frustrate the purpose of the Contract Clause as may new statutes, at least where the decision, as here, creates a broad, new and unforeseen principle out of a vaguely worded statute.

The Contract Clause is designed to ensure that "government accommodate private expectations by acting only pursuant to rules fixed and announced beforehand . . . ." Note, *Rediscovering the Contract Clause*, 97 Harv. L. Rev. 1414, 1429 (1984). It ensures that citizens can be secure in their undertakings in commerce and that they can reasonably rely on them. It is intended "to shield [citizens] and their property from the effects of those sudden and strong passions to which men are exposed." *Fletcher v. Peck, supra*, 6 Cranch at 137-38. The undermining of government contracts invokes "special concerns," *Exxon Corp. v. Eagerton*, ___ U.S. ___, ___ n.13, 76 L.Ed.2d 497, 511 n.13 (1983), because the government, like any contracting party, may not view its own contractual undertakings with the same unjaundiced eye as it might cast upon contracts in which it has no direct interest.

Those principles are equally endangered when the dislocation results directly from the novel and unexpected interpretation of a pre-existing statute as from enactment

of a new statute. Although the court below invoked a pre-existing statute, that statute's broad language merely provided a shapeless mass out of which the court formed its theory that permits the City of San Juan and others to walk away from their contracts. When the judiciary announces such a broad, legislative-type rule that extinguishes major contractual obligations, the decision should be subject to scrutiny under the Contract Clause. The decision below would not survive that examination.

III. THE INTERESTS AT STAKE ARE IMPORTANT.

The Puerto Rico Supreme Court has vested in government a power that threatens substantial and immediate harm to the rights of all citizens who do business with the government. The Commerce Department estimates that, in 1983, state and local governments purchased over $174 billion in goods and services from private suppliers. Bureau of Economic Analysis, 64 Survey of Current Business, No. 4, Table 3.3 at 15 (April 1984). Under the Puerto Rico Supreme Court's theory, contingent fee contracts with states and municipalities may no longer be enf. .ceable by the provider of services if he does such a good job that he earns a large fee.

Moreover, nothing said by the court below limits its decision to contingent fee contracts. Any contract, freely negotiated and fairly arrived at, is subject to reexamination by the government after performance by the other party. If a government official decides not to pay for the goods or services, a court is then empowered, as the Puerto Rico Supreme Court has done here, to review the terms of the contract to determine whether the court believes, with the benefit of hindsight, that the performing party really "earned" the full fee that the contract provides.

In recent years, state and local governments have faced severe fiscal crises and shrinking tax bases, and they

have been casting about for ways to cut back on their expenditures. *See, e.g., Special Report: State and Local Government in Trouble,* Business Week, Oct. 26, 1981, at 135-81. Nothing would be more tempting to financially distressed governments than to be able to repudiate or to shrink their contractual obligations after the other party has already performed. The general public would not feel the impact, either in lost services or in increased taxes, if the service already has been provided and the subsidy is to be extracted from the contracting party alone. Armed with this power, therefore, the temptation to use it may be irresistible.

The Constitution, however, is designed to protect citizens from this type of inequitable treatment. At the height of the Great Depression, this Court stood firm in insisting that the Constitution prohibits the government from repudiating its contractual obligations. *Lynch, supra.* More recently, the Court has reaffirmed that the Constitution prevents local governments from seeking to finance new projects by refusing to pay for existing ones. *U.S. Trust, supra.* The Court has also held that government may not withhold the payment stipulated by contract after the other party has performed simply because a government official thinks that the government should have negotiated a better deal. *Bethlehem Steel Corp., supra.*

The decision below creates a rule that authorizes state and municipal governments to disregard each of those principles. This Court, therefore, should reaffirm that under the United States Constitution no State or municipal government may treat its citizens as the City of San Juan has been allowed to treat UCS here.

CONCLUSION

The Court should note probable jurisdiction.

Respectfully submitted.

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JULY, 1984.

APPENDIX A

Unofficial Translation

IN THE

SUPREME COURT OF PUERTO RICO

UTILITY CONSULTING SERVICES, INC.
Plaintiff and Appellee,

v.

CITY OF SAN JUAN AND DR. HERNÁN PADILLA
Defendant and Appellant

No. R-83-51
R-83-52

JUDGMENT

San Juan, Puerto Rico, February 14, 1984

The City of San Juan retained the consulting services of the corporation Utility Consulting Services, Inc., to analyze the tariffs and invoices pertaining to the contracts for the supply of water and electricity, and review ("audit", according to the English text) invoices already paid and to explain to the City the bases to reclaim overpayments. It was agreed that the consulting firm would receive for these services 50% of all the savings resulting from its action, computed over a period of three years after the readjustment is made; and 50% of the refunds and credits that would be obtained by the City government. The contractual period was set for three years as of July 2, 1973, subject to an indefinite extension of time until any of the parties give 120 days prior notice of cancellation. This notification came from the mayor, Mr.

Hernán Padilla, on April 18, 1978. While the contract was in force the City paid $232,138.62 to the said consulting firm. After October 3, 1977, the City made no further payments and Utility Consulting sued for payment of services in April 1980. The case was heard and the court, when applying the formula agreed to in the consulting contract, ordered the City to pay $2,516,905.48, a sum in excess of the adjustments or credits of $2,404,101.38 by which the City of San Juan benefitted. We issued a writ of revision as requested by the City and having considered the extensive briefs of both parties, resolve as follows:

PART I

There is very clearly an exorbitant disproportion between the obligations of the contracting parties leading to the collapse of the contract because of the destruction of the equilibrium between these mutual obligations. For simple and sporadic work which on occasion amounted to cleaning the window of a forgotten meter and discovering that the ratio (coefficient) of the tariff was 700 and not 7,000 as was invoiced, for the use of a minimum amount of time and hours which is unspecified, the appellee invokes the contract* to justify its claim of $2,749,044.10 in public funds, generated mainly during the *three years following* its audit.

The deeply-rooted tradition of the autonomy of the will ("pacta sunt servanda"), which is the essence of juridical certainty, allows for mitigation of its effects when the excessive burdens reach the dimensions of bad faith. c/f *Lopez de Victoria v. Rodriguez*, 82 JTS 109; CA-1982-108. So the Civil Code directs in its Art. 1210 (31 L.P.R.A. sec. 3375) when it provides that contracts bind

* For these services, Utility Consulting Services would receive 50% of the reduction in the electric and water bills during the three years subsequent to its modification, adjustment or correction; and credits attributable to the actions of the consultant.

all to the consequences which, according to their nature, are in accordance with *good faith,* use, and the law.

In appropriate cases, we would not have to go so far as to invalidate liberty of contract, resorting instead to the alternative of reformation of the contract, an intermediate concept between the two extremes of validity and nullity, the nucleus of which is the partial substitution of the private will by state will which preserves the essential effectiveness of the transaction. Royo Martinez, *Concepto del Contrato en el Derecho Moderno,* Rev. General de Legislacion y Jurisprudencia, Tomo XIX (177 de la coleccion) febrero de 1945, pags. 113-157 y sigs. Puig Pena, *Compendio de Derecho Civil Espanol,* To. 3, Tercera Ed. (1976) pags. 338 y sigs.

Courts have the power to temper the irrationality of the cause when this offends the principle of reciprocity (of services) and good faith, cited in Art. 1210.

> "Our civil legislation addresses the problem of the autonomy of will, which requires the fulfillment of what had been agreed to in the very terms agreed to; however, it admits certain restrictions by reason of good faith that prevails in agreements—arts. 1,258 del C.C. y 57 del de Comercio—and specifically by reason of the element of objective justice implicit in the demand for cause in contracts, referred to, essentially, in the onerous ones of reciprocity or equality of services; our modern legislation has been more direct with regard to moderation of that agreed to, precisely recognizing the judicial power to modify the contract, but only with great caution and clear justification can the said modifying power be used. (S. de 13 jun. 1944)." Bonet Ramon, *Codigo Civil Comentado,* [Commentary on the Civil Code], Segunda Ed. (1964) pag. 959.

The judicial revision of the contract under discussion is feasible because (1) the development which occurred with regard to the equality of value of services and counter services could not be forseen; (2) the execution of the contract is extremely onerous and constitutes, for the debtor, an injury which is out of proportion to the advantage foreseen for him in the contract; and (3) the contract has no aleatory character or of pure speculation with which the parties could foresee in any way the unexpected alteration of the equilibrium between obligations. Castan Tobenas, *Derecho Civil Espanol, Comun y Foral*, Decima edicion (1967) To. 3, pag. 486. c/f *Casera Foods, Inc. v. E.L.A.*, 108 D.P.R. 850, 856 (1979).

Our cautious intervention is fulfilled by revocation of the judgment, without considering the counterclaim in which the city seeks restitution of $232,138.62 already paid.

PART II

When filing the action against the City of San Juan to recover the cost of services under a consulting contract, the plaintiff corporation included, as a defendant in his personal capacity, Dr. Hernán Padilla, Mayor of the City, from whom it claimed (apart from the contractual obligation) $250,000.00 for damages, for his refusal and denial to pay for defendant's alleged services. The Mayor answered the complaint and on the day of trial, after the plaintiff submitted its evidence, requested dismissal for insufficient evidence, which was accepted by plaintiff, stating that it withdrew its action against the Mayor. The Superior Court did not grant the dismissal until the case was submitted in its totality when, in its judgment of 10 November 1982, it stated: "With regard to co-defendant Dr. Hernán Padilla nothing is provided in this sentence

since the plaintiff withdrew with prejudice its cause of action during the trial and the same having been accepted by this Court." Defendant appealed for a rehearing pointing out as the only error that the court did not provide for payment of costs and attorneys' fees. We issued a writ for revision on 10 March 1983 and the appellant submitted a brief in support of its request and the appellee has not refuted the same.

The imposition of costs is mandatory (Rule 44.1 Civil Proc.); and it seems to us that to keep a person subject to trial for three years and finally to desist—without further explanation—when faced with a motion to dismiss for lack of evidence, shows flagrant and abusive conduct that injures and subverts the freedom of access to courts in search of relief. Rule 44.1(d) Civil Proc.; c/f *Kane v. Republica de Cuba* (1964) 90 D.P.R. 428.

The judgments are reversed and the complaint dismissed, with costs on the plaintiff. The trial court, moreover, will set the attorneys' fees for the benefit of the Mayor in the personal action dismissed.

Thus decided and ordered by this Court and certified by the General Clerk. Chief Judge Mr. Trias Monge and Associate Judge Mr. Negron Garcia recused themselves. Associate Judge Mr. Rebollo Lopez dissented in his own opinion.

LADY ALFONSO DE CUMPIANO
General Clerk

DISSENTING OPINION RENDERED BY ASSOCIATE JUDGE MR. REBOLLO LOPEZ

San Juan, Puerto Rico February 14, 1984

In the dissenting vote rendered in the case of *Morales Vda. de Zayas vs. Pepsi Cola Bottling Co. of Puerto Rico, Inc.*, et. al., judgment dated November 9, 1983 (83 JTS 102) we stated that to be consistent is no assurance that we are deciding correctly, but at least, it represents in our function of rendering justice a spiritual tranquility.

The consistency in our decisions promotes the excellence in the exercise of the profession since it allows the attorney to be able to evaluate factual situations before their consideration in their fair perspective; therefore, it allows them to adequately and intelligently counsel their clients about the different options that they have. The fact that it tends to prevent uncertainty in our judges when they are faced with the cases that they have to decide, is just as important. So the fact that we are consistent is very important since it promotes in our jurisdiction, legal security ". . . said uniformity is the axis of our law . . ." *Jack's Beach Resort Inc. v. Compañia de Turismo de Puerto Rico,* opinion dated March 18, 1982 (82 JTS 40).

That of course does not imply that this Court, or any other is inflexible and inexorably bound to what was decided in the past. The law is dynamic and, therefore, constantly changes; it however does not change suddenly or radically from one day to the next and from one week to the other.

I

In *Lopez de Victoria v. Rodriguez* (82 JTS 109)[1] we had the opportunity to express ourselves about a contin-

[1] Judgment dated June 19, 1982, publication ordered by this court.

gent fee contract for professional services rendered between an attorney and his client, concerning a divorce suit and liquidation of the property in the conjugal partnership. In the judgment rendered we upheld the one summarily rendered by the trial court granting the complaint for collection of monies filed by the attorney, therefore ordering the client to pay the total amount of fees agreed to.

We stated in the cited case that even though ". . . the attorney's professional services contract is saturated by an ethical element substantially differentiating it from a common services lease agreement . . ." it should therefore be more rigorously examined than a common or current service contract. We stated that this is not the case requiring a moderating intervention of the court in the *contractual autonomy* of the parties which only occurs in *extraordinary circumstances,* power emanating from the cited article 1210CC "*which should be applied with extreme caution and patent justification due to its damaging effect on the stability of the contracts and juridical security.*" (Emphasis added).

In an opinion dated October 21, 1983 in the case of *Plan de Bienestar de Salud v. Honorable Mayor of Cabo Rojo,* 83 JTS 87, a case in which the mayor of Cabo Rojo had agreed to pay, through administrative order, a specific amount of money as the employer's contribution to a Health and Welfare Plan on behalf of the cleaning employees of said municipality and although the Plan referred to rendered the services required, the Mayor refused to fully pay the employer's quota and when sued by the referenced Welfare Plan for collection of monies, the Mayor alleged that he did not have to do so since the administrative order constituted a null act and ultra vires on his part—this court stated, when it reversed the

judgment rendered by the trial court dismissing the complaint filed:

> *"Aside from the juridical nature of a municipality in Puerto Rico, it is clear that the obligations contracted are regulated by civil rights principles subjected to statutes modifying said situation. The administrative contracts are normally regulated in the absence of a special regulation, by the general contract theory .... This means that among other, the unjust enrichment doctrine may be applied to certain situations in which one of the contracting parties is a public entity .... Even assuming that the agreement reached may be voided or is null since it failed to comply with certain legal formalities, it is an offense to elemental principles of equity, in the civil sense of the word, that a municipality may benefit from an agreement in the specific circumstances of this case and also evade all responsibility in regards to what was freely agreed by it."* (Emphasis added).

In *Colondres Velez v. Bayron Velez, Mayor,* opinion of December 7, 1983 (83 JTS 108) case in which the City of Maricao refused to comply with a purchase and sale contract that it had executed by which it had reacquired in 1980 for $35,000.00 a lot and building, property which the City itself had sold to the other party two years before in the amount of $800.00—citing as its only basis that provided by Article 1210 of the Civil Code for Puerto Rico, section 3375.[2] We affirmed the judgment rendered by the trial court, a judgment that upheld the validity and effectiveness of the contract executed.

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[2] "Contracts are made through the mere consent and are binding from thereon, not only to compliance with what was expressly agreed, but also to all of the consequences that, because of their nature, are in accord with good faith, custom and the law."

In this case the plaintiff corporation executed a service contract with the City of San Juan—a contract which was prepared by the legal advisor of the referenced City and signed by the Mayor—by which it was bound to pay the plaintiff 50% of the total amount of money by which the City would economize during the effective period of the contract as a result of economies or credits in its behalf relating to the consumption of electric power in all of its facilities.

It is an undenied fact that the City of San Juan as a direct or indirect result of the work done and counseling offered by the plaintiff corporation[3] received credits and savings in excess of the amount of five (5) million dollars.[4]

The referenced City started to pay and then refused to honor the contract it had executed freely, alleging that it was null. The trial court, in a well reasoned judgment and based on the clauses included in the contract executed, ordered the referenced City to pay the plaintiff half of the amount of money that the plaintiff corporation had saved.

Using as a basis, erroneously to our judgment[4B], the cited provision of Article 1210 of the Civil Code and abandoning the rule established in the case of *Lopez de Victoria v. Rodriguez,* to the effect that ". . . the moderating intervention of the court in the contractual freedom of the parties . . ." should be exercised ". . . only in extraordinary circumstances . . ." and ". . . with extreme caution and patent justification . . ." this court reverses said decision injuring, from our point of view, ". . . the stability of the contracts and juridical security . . ." in our jurisdiction.

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[3] . . . work which was not so simple as indicated by the Court in Part No. 1 of the Judgment rendered.

[4] Exactly the amount of $5,033,810.96.

[4B] Document transcribed at the end of the exposition.

II

In addition to what was stated in the recent case of *Plan de Bienestar de Salud v. Honorable Alcalde de Cabo Rojo,* to the effect that obligations binding the City " . . . are governed by principles of civil law . . ." and that administrative contracts are normally regulated by " . . . the general contract theory . . ." it is fully established in this jurisdiction that a contract between the government and a particular citizen should be interpreted as if it were a contract between two particular persons. *Rodriguez v. Municipio,* 75 DPR 479; *Zegueira v. CRUV,* 83 DPR 878; Opinion by the Secretary of Justice No. 17 of 1972, No. 11 of 1977 and No. 15 of 1978. It is rather clear, that the obligations contracted by the City of San Juan with the plaintiff through the contract in controversy herein must be examined on the basis of civil law principles, specifically, the general contract theory.

Therefore, in relation to this case, what is provided by our Civil Code is important, such as that provided by Article 1207[5] which endorses the principle of the autonomy of the will when it points out that the " . . . contracts may establish pacts, clauses and conditions that they deem convenient, if and when they are not contrary to law, morals, or public order"[6]; those of Article 1230[7], through which we try to maintain the exercise of this contractual liberty separate from the formal requirements, so that the " . . . contracts are binding, despite the way in which they have been executed, if they have the essential conditions for this validity . . ."; and finally article 1208[8] provides to

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[5] 31 LPRA sec. 3372.

[6] In regard to this particular matter see: *Burgos v. Registrar,* 91 DPR 112; *Castle Enterprises, Inc. v. Registrar,* 87 DPR 775; *Clausells v. Commercial Union Assurance Co.,* 37 DPR 117; *Tastee Freeze de PR v. Employment Security Bureau,* 108 DPR 495.

[7] 31 LPRA sec. 3451.

[8] 31 LPRA sec. 3373.

that effect that " . . . the validity of and compliance with contracts may not be left to the whim of the contracting parties . . ."

Much has been written about contracts. Puig Brutau points out in its pertinent part, that this autonomy " . . . means that, in principle, any particular person may contract when he so wishes, as he pleases and with whom he pleases".[9] Manresa says that product ". . . the free contracting and agreement of the wills of the interested parties to create a special juridical relation, it will be preferably regulated, as we have stated, by that which those bound wished and agreed to . . ."[10]

In regard to this, Diego Espîn Canovas states that ". . . one of the traditional characteristics of the contractual right is the scope in which the parties may create and regulate their own interests, using for this the form of the contract, which becomes a juridical mold able to gather any economic content . . ."[11]

In relation specifically to contracts executed between a municipality and a particular person, it is of utmost importance to point out that once it is executed, the general doctrine of the unalterability of contracts applies, that is, the maxim of "Pacta Sunt Servanda". In regard to this, commentator V. Balbin Pechuan states in his book *Municipal Contracts,* that:

> "The administrative contract, once it is executed by the definite award, must be executed and complied with, not in any manner, but pursuant to that agreed by the contracting parties, that is, according to what was agreed,

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[9] Puig Brutau, *Fundamentals of Civil Law*, 2d. Ed. Bosch, 1978, Book 2, Vol. I, page 1.

[10] Manresa, *Commentaries on the Spanish Civil Code*, 6th Ed. Reus, Book 8, Vol. VIII, page 380.

[11] Diego Espîn Canovas, *Manual of Spanish Civil Law*, 4th Ed., *Review of Private Law*, Editorial, 1975, Vol III, pages 355-356.

which is what the basic principle *pacta sunt servanda* means. This conforms with what was agreed and this compliance with what was agreed to in the contract not only is important to the contracting parties, but it is also important to the social peace. We are constantly contracting, since most of the human acts are contracts of one or another nature, *so if they are not complied with or cannot be complied with freely, a real chaos would occur in society.*" [12] (Emphasis added)

III

The principle of the autonomy of the will is subjected naturally to that freely agreed to by the parties, is not contrary to the laws, moral, nor public order. The contract before us clearly is not. As the plaintiff states, the Court in its interpretation of the term "public order" consistently has searched for the expression in the law.

In this respect, writer Scaevola states that:

> "The public order concept, in itself, separated, aside from the idea of law, it seems to us that it lacks effectiveness in the contracting field. We still can talk of morality as being independent from law; however we cannot conceive public order, that is, ordainment of social life, without a set of rules determining it. It is precisely public order because the legislator so states, or, even without him so expressly stating, it is, since what is legislated affects the general interest. *Public order outside the law, is in a vacuum, it does not exist* . . . .

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[12] V. Babin Pechuan, *Municipal Contracts*, page 125; *Asociacion de Condomines v. Seguros Arana*, 106 DPR 133; *Asociacion de Condomines v. Centro I, Inc.* 106 DPR 185; *Hernandez v. Mendez*, 105 DPR 149.

. . .

> Finally: *agreements against public order must be understood are contrary to law,* be it in itself and strictly and in its totality public law, private law, but affecting in determined principles the social interest." [13] (Emphasis added).

C. Antieau in his work *1A Municipal Corporation Law,* Matthew Bender, 1980, pages 10-43, enumerates situations in which municipal contracts have been voided since they are against public interest. Among others he points out a) excessive duration of the contract beyond the term of the municipal authorities; b) unreasonable limitation of powers of the successor officers; c) waiver or undue delegation of governmental powers; d) conflict of interests of the municipal officers involved. We have been unable to find one single case, nor author, holding contrary to public order a contract like this one in which some contingent fees are agreed to for some professional service to be rendered.

What can be illegal or immoral in a contract whose object is to reduce in a legitimate manner the operating expenses incurred by the municipality? Isn't the reduction of expenses in electric power by the government a good and desirable public policy?

What can be illegal or immoral in a contract when it expressly agrees that the right and amount to be collected by a party directly depends on how beneficial the lawful endeavors to be carried out by the former are for the municipality?

We believe that the only conclusion in this case is that there is no legal basis whatsoever to nullify the contract in controversy because it is contrary to law, moral or public order . . . The stipulation would be different if it would have been shown that there was fraud or turbid maneu-

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[13] Scaevola, *Civil Code,* 2d Ed., 1958, Vol. 20 pgs. 586-587.

vers in the agreement,[14] events which in this case were not alleged by the City of San Juan in its reply to the complaint.

The contract executed, finally, is not an ultra vires one. We must first point out that, as a general rule and specifically in regards to municipal governments, a contract executed between the City and a particular person is only ultra vires if it does not fall within the municipal powers under any circumstances or for any purpose. C. Antieau in his work *Municipal Corporation Law*[15] states, in its pertinent part, that:

> "The term ultra vires has been employed to mean many different things. Thus, it is not uncommon to refer to contracts as ultra vires where made by the wrong municipal officer or without the formalities required by the law. The improper use of this term has been productive of much confusion and for the purpose of clearly defining the rights and the duties of all the parties to a municipal contract, *an ultra vires contract, as the term will be used herein, and according to its strict and true construction, is a contract which it is not within the power of a municipal corporation to make under any circumstances or for any purpose.*" [16] (Emphasis added)

Can it be validly argued that the City of San Juan lacked the power to execute the contract in controversy herein, under any circumstances, or that said contract did not have any valid purpose? We believe not.

As McQuillian very well points out on page 234 in his above mentioned work, *Municipal Corporations Law*,

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[14] By the way, the defendant City has the burden of proof. *Serrano v. Torres*, 61 DPR 162.

[15] C. Antieau, 1A *Municpal Corporation Law*, Matthew Bender, 1980, pages 10-35.

[16] 10 McQuillian, *Municipal Corporations Law*, Callaghan, 3rd Ed., 1981, page 236.

". . . a city may enter into contracts *in aid* of the performance of its public duties . . ." (Emphasis added).

IV

Summarizing, we see that the contract voided by the judgment rendered by the Court is not ultra vires nor is it contrary to law, morality or public order. Its purpose is a legitimate one and beneficial to the City of San Juan, to economize public funds which were unnecessarily spent in the consumption of electric power, funds that may be used in other ways to benefit the citizens of that municipality.

The consequences of the subject contract were clear and foreseeable; the plaintiff would be entitled, as contingent fees, to half of what its endeavors and recommendations saved for the City. Said contract was freely agreed to by the parties; in fact, as we stated previously, it was prepared by the legal advisor of the City. It was definitely not a "weak party" that was bound to accept the terms imposed by the "powerful party".[17]

We believe that the function of this Court when deciding a case such as this one is not to determine, a posteriori, the "convenience" or not of the terms of the contract executed or what, according to the individual criteria of each one of us, they should have been. Our function is limited, according to law, to determine the legality of the contract.[18] We should not exercise, in regards to municipalities in Puerto Rico, a power similar to "parens patriae" that we exercise in relation to minor children.

Based on the foregoing, the court states that the contract executed should be voided because "there is an exorbitant disproportion between the services of the contracting parties . . ." in view of the ". . . simple and

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[17] *See, C.M. & Finance Corp. v. Cooley*, 18 DPR 6.

[18] *See, Middlesex County Sewer Authority v. Middlesex Borough*, 181 A. 2d. 818.

sporadic work . . ." that the plaintiff corporation carried out.

We believe that just as in the case of *Lopez de Victoria v. Rodriguez,* ". . . this is not the case requiring a moderator's intervention by the court in the contractual controversy of the parties."

In the first place and in addition to the aforementioned circumstances surrounding the execution of the contract in this controversy, neither party really knew what would be the outcome or result of the work to be done by the plaintiff corporation. It could have been the case that the economies resulting for the benefit of the City of San Juan could have consisted of a nominal amount. In that case the fees that plaintiff would have claimed, not only would not have been noticed by anybody, but in that case the plaintiff would surely have lost money if we compare the small amount of fees to which it would have been entitled for the hours and efforts invested by it in the work done. Of course, that was the risk that the plaintiff corporation was taking under the executed contract.

However the result was that the work done was a success probably not foreseen by any person. It is possible that for a moment the magnitude of the fees claimed by the plaintiff are noticed. We must not forget, however, that for each dollar to which plaintiff is entitled under the contract executed, the City of San Juan saves one dollar. The City referred to was not taking any risk whatever under the contract executed.

That is precisely on what the justification, and up to a certain point the "glamour", of the contingent fees contracts is based: the client does not have to make any disbursement of fees. He who invests his time, effort and even his money is the other party, relying on the fees that he may receive in proportion to the success of his endea-

vors and, therefore, in direct proportion to how his client benefited.

To determine that under the present circumstances of this case that is in order for the court to intervene and therefore to void this type of contingent service contract constitutes, in our way of seeing things, a mortal blow for the juridical certainty that may exist in our jurisdiction, which even may take us to chaos on which commentator V. Balbin Pechuan expresses himself in his previously mentioned work.

Does the decision rendered by this Court today mean that from hereon the realtor to whom the sale of a property is given or an attorney who has been assigned a case for damages may not be able to collect from their respective clients at the percentage agreed in the contract executed since the house was sold or the case was settled with a simple telephone call?

Are the fees to be collected in the contingent contracts going to depend on the hours really worked or the number of endeavors made? If by a mere stroke of the pen you can discard the percentage freely agreed to by the parties in the contract executed, based on what criteria are the courts of justice to assess said work? What guidelines are there for this?

In the second place, the moderating intervention of the court in the contract executed is not justified because supposedly there exists an ". . . exorbitant disproportion between the services rendered by the plaintiff corporation and the contracting party . . ." Therefore the work done by the plaintiff corporation was not merely limited to what is stated in the judgment rendered. The plaintiff is a domestic corporation dedicated to rendering advisory services in electric power, water and fuel matters. For this it has personnel with a degree in engineering. As an example and in relation to the work done by them in

behalf of the City of San Juan, the record shows that said personnel discovered, among other things and in relation to a drainage pump owned by the City, what its personnel for years had not discovered: they were able to verify that the billing was based on estimates and that the basis for those estimates was erroneous since it assumed a constant utilization of electric power when the truth was that said drainage pump only operated when water accumulated in the streets. This discovery, alone, resulted in a saving for the City of San Juan of $2,431,228.84.[19]

The work done definitely could not have been so "... simple and sporadic ..." as alleged. The proof of this is that the Court in its judgment rendered concludes that " ... our intervention is completed when the judgment is reversed, *without considering the counterclaim in which the City requests restitution of the $232,138.62 already paid.*" (Emphasis added)

The contradiction is apparent, the Court itself recognizes that what it classifies as "... simple and sporadic ..." really is not.

Finally, even assuming for the purpose of argument that the work done was extremely simple—the truth is that the work done by the plaintiff corporation saved the City of San Juan the amount of $5,033,810.96. The truth is that the City, even after it had paid half of said amount of money, that is $2,516,905.48, for fees, saves exactly the same amount of money, that is $2,516,905.48, funds which may be used by said City to carry out work in behalf of the citizens of San Juan. Is it reasonable for the city to so benefit without having to pay what it agreed to? As the Court stated—in the recent case of *Plan de Bienestar de Salud v. Honorable Alcalde de Cabo*

[19] See Determinations of Facts number 11, 12, 13 and 14 of Judgment rendered by the trial court.

Rojo—Isn't it contrary to equity in the civil sense of the word, that the city may benefit from an agreement in the specific circumstances of this case and also to evade all responsibility for what it freely agreed to?

In sum, we dissent in the present case since we understand that the decision rendered by the Court today constitutes a step back and undermines the freedom to contract and therefore it is against the juridical security and certainty that should prevail in our Country. I, therefore, confirm the judgment rendered by the trial court in this case.

FRANCISCO REBOLLO LOPEZ
Associate Judge

APPENDIX B

Unofficial Translation

IN THE
SUPERIOR COURT OF PUERTO RICO
SAN JUAN PART

UTILITY CONSULTING SERVICES, INC.
Plaintiff

VS.

CITY OF SAN JUAN and DR. HERNÁN PADILLA
Defendants

Civil No. 80-2500 (807)

Re: Civil Action,
Collection of Monies and Damages

Summary of the Case, Findings of Facts,
Conclusions of Law and Judgment

SUMMARY OF THE CASE

The plaintiff in this case, Utility Consulting Services, Inc., filed the above mentioned complaint demanding from the defendant the fulfillment of the payment for services rendered as agreed to in a contract between the parties and the damages.

The defendant, Dr. Hernán Padilla, answered the complaint denying the allegations and requesting the

dismissal of the complaint. The defendant, City of San Juan, answered the complaint admitting the existence of the plaintiff Corporation and their function as consultants and accepting also the existence of the contract with the plaintiff as was established by the executed contract. The City of San Juan filed a counterclaim alleging that the contract had been prescribed and also that it had been opportunely cancelled and also that the contract was null, nonexistent and ultravires.

The Court, after several sittings, held the Pre-Trial Conference on November 10, 1981, having adopted as its act to rule the proceedings of the trial the report on Status Conference Between the Attorneys signed by the attorneys for the above mentioned parties.

The hearing of the case was set for December 14 .nd 15, 1981, and it was suspended as requested by the defendant. Afterwards, the hearing was set for February 16 and 17, 1982, and it was suspended as Ordered by the Supreme Court based on request for Certiorari filed by the defendant on February 10, 1982. The Supreme Court issued a Resolution on April 15, 1982, dismissing the Certiorari resourde, to which the defendant filed a Motion for Reconsideration, which was also dismissed.

Once the Order was received, the Court set the case for hearing on September 29, 1982. The hearing was held on September 29, 1982, October 19, 1982 and November 3, 1982.

Having studied the evidence, documentary as well as oral, the Court makes the following:

FINDINGS OF FACT

1. The Plaintiff, Utility Consulting Services, Inc., is a corporation organized under the Laws of the Commonwealth of Puerto Rico, offering counseling and consulting services in services and electric power matters.

2. Through letter dated January 16, 1973, the plaintiff offered its services to the defendant, stating the system to render the services and the payment agreement suggested for the services rendered. In this letter it submitted a draft contract.

3. Mr. Miguel Rivera Ríos, then Executive Advisor for the Mayor of the City of San Juan, favorably recommended the proposal and referred it to the legal office of the City for study.

4. Attorney William H. Preston Giusti, at that time Legal Advisor for the City of San Juan, favorably recommended the service and pursuant to instructions from the city executive proceeded to prepare the service contract, which was later signed, on July 5, 1973, by the then Mayor of the City of San Juan, Attorney Carlos Romero Barceló, and the representative for the plaintiff, Mr. Héctor M. Santana.

5. That in clause seven of the contract executed between the parties, in regards to payments, it provides for two types and for occasions in which the defendant would be bound to pay monies for services rendered, to wit:

> a) An amount equal to 50% of any of the savings that would be experienced by the City of San Juan, as a result of the services rendered by the plaintiff, during the period included in the next 36 months after the modification, adjustments or corrections that said savings would cause in the accounts or services contracts of the City.
>
> b) An amount equal to 50% of any credit or reimbursement of money paid, granted and/or obtained by the defendant as a result of the services rendered by the plaintiff.

6. That pursuant to the aforementioned contract, the plaintiff proceeded to comply with its part as agreed and

on October 3, 1977, the City of San Juan had paid for credits and savings had in the invoices corresponding to the service rendered by the Electric Power Authority, thanks to the endeavors by the plaintiff, in the total amount of $232,138.62.

7. That the City of San Juan operates and is responsible for the payment for electric power consumption of a pump station for a water sewer system located on McLeary Street corner to María Moczo in Santurce, Puerto Rico, being billed for the electric power consumption of the mentioned pump by the Electric Power Authority under account No. 10-11007-5200.

8. That due to the services rendered by the plaintiff, the defendant, the City of San Juan, received a credit on June 28, 1978, under account number 10-11007-5200 of $313,552.12, money collected in excess by the Electric Power Authority due to a billing mistake, which was discovered and claimed by representatives of the plaintiff, on behalf of the City of San Juan.

9. That as agreed, the plaintiff billed the defendant the amount of $156,775.56 for its services. Based on said invoice, and after the credit was accepted by the City of San Juan, on account No. 10-11007-5200, Ordinance Proposal No. 26, series 1978-79, was presented by the representatives of the City to the San Juan Municipal Assembly to amend municipal ordinance 51, series 1977-78, known as the Budget Ordinance for the year 1978-79, to authorize payments to the plaintiff pursuant to the contract executed between the plaintiff and the City of San Juan; to authorize the transfer of funds to pay said obligation and for other purposes. This ordinance proposal never became an ordinance since it was withdrawn by the City of San Juan when it refused to honor the contract executed between the parties.

10. That the savings that the City of San Juan received pursuant to the credit granted on account no. 10-11007-5200, during the 36 months subsequent to the aforementioned credit, corresponds to the amount of $198,454.00 for which, when the contract's payment clause was applied, the plaintiff billed the City of San Juan and the Mayor of San Juan at present owes the plaintiff the amount of $99,227.00, which has not been paid until now by the defendant.

11. That the City of San Juan operates and is responsible for the payment for electric power consumption of a pump station for a water sewer system located at 1426 Wilson Street, Santurce, Puerto Rico, being billed for the power consumption by the Electric Power Authority under contract no. 10-11056-24500.

12. That due to the services rendered by the plaintiff, the defendant, City of San Juan, received a credit under account no. 10-11056-24500 in August, 1978, of $148,890.64 and another one in June 6, 1978 in the amount of $1,941,658.62 for a total credit under the aforementioned account of $2,090,576.20, monies collected in excess from the City of San Juan due to a billing error discovered and claimed by representatives of the plaintiff on behalf of the City of San Juan.

13. That based on the credit granted to the City of San Juan under account no. 10-11056-24500 in the amount of $2,090,576.20, the plaintiff billed the City of San Juan in the amount of $1,045,288.10, payment not honored by the defendant, City of San Juan.

14. That the savings received by the City of San Juan, in relation to the credit granted under account no. 10-11056-24500, during the 36 months subsequent to the credit granted is in the total amount of $2,431,228.84, for

which, when applying the contract's payment clause the plaintiff billed the City of San Juan the amount of $1,215,614.82, which was billed and the City of San Juan has refused to pay.

15. That plaintiff complied with its part of the service contract billing for the services rendered based on the credits and savings granted by the Electric Power Authority to the City of San Juan and the City of San Juan refused and refuses to this moment to pay the amounts claimed based on the savings and credits granted although it has been corroborated that the City of San Juan has benefited from the credits and savings obtained through the services by the plaintiff.

16. That defendant City of San Juan, through letter signed by Dr. Hernán Padilla, Mayor of San Juan, and dated April 18, 1978, acting pursuant to clause 13 of the contract executed between the parties on July 5, 1973, cancelled it effective 120 days after receipt of the letter, that is, to be effective on August 18, 1978.

17. That clause 9 of the contract executed between the parties provides that the savings that the City of San Juan receives after the expiration or cancellation of the contract, but that are based on the advice or recommendations given by the plaintiff prior to the expiration or cancellation of the contract, the City of San Juan will be bound to make the payments in the manner established in clause 7 of the contract which is the one referring to payments.

18. That the representatives of the plaintiff as well as Attorney Antonio Córdova González, carried out numerous endeavors trying to collect the payment of the amount owed by the City of San Juan to the plaintiff in an extrajudicial manner, but all endeavors were fruitless.

Based on the aforementioned, the Court arrives at the following

CONCLUSIONS OF LAW

1. Obligations arise from the law, contracts or quasicontracts, and from the acts and unlawful omissions or one in which any guilt or negligence is involved. Article 1042, Civil Code of 1930 (31 LPRA 2992)

2. The obligations which arise from contracts have force of law between the contracting parties and should be fulfilled pursuant to them. Article 1044, Civil Code of 1930 (31 LPRA 2994).

3. A contract exists from the moment that one or several persons consent to bind themselves in regards to another or others, to offer something, or render some service. Article 1206 of Civil Code of 1930 (31 LPRA 3371).

4. A contract executed between the government and a particular person should be understood as if it were a contract between two particular persons. *Zequeira* vs. *Corporación de Renovación Urbana y Vivienda* (Housing and Urban Renewal Corporation), 83 D.P.R. 878 (1961), and *Rodriguez* vs. *Municipio*, 75 D.P.R. 479 (1953).

5. The validity of and compliance with the contracts may not be left to the whim of the contracting parties. Article 1208, Civil Code, 1930 (31 LPRA 3373).

6. The contracts are made by the mere consent, and after that, bind not only to the compliance with that agreed to but also to consequences that because of their nature, are in agreement with the good faith, the use and the law. Article 1210, Civil Code, 1930 (31 LPRA 3375).

7. That the amounts claimed by the plaintiff in this case are liquid and demandable amounts and the City of San Juan is bound to comply with its payment.

JUDGMENT

Pursuant to the aforementioned findings of facts and conclusions of law, made part of this document, judgment is rendered against the City of San Juan in the amount of $2,516,905.48 for services rendered and not paid in violation of that stipulated in the service contract dated July 5, 1973, from the credits and savings had by the City of San Juan for services rendered by the plaintiff pursuant to the contract described; plus legal interest as of the date of this judgment. Since no evidence has been submitted to support the counterclaim, the counterclaim filed by the City of San Juan is denied. In regards to co-defendant, Dr. Hernán Padilla, nothing is provided in this judgment since plaintiff withdrew without prejudice said cause of action during the proceedings and it was so accepted by this Court.

REGISTER AND NOTIFY.

Issued in San Juan, Puerto Rico, on November 10, 1982.

(signed)

PEDRO J. MARTINEZ MONTAÑEZ
Superior Court Judge

APPENDIX C

Unofficial Translation

IN THE

SUPREME COURT OF PUERTO RICO

UTILITY CONSULTING SERVICES, INC.
Plaintiff and appellee

v.

CITY OF SAN JUAN and
DR. HERNÁN PADILLA
Defendant and appellant

No. R-83-51
Revision

RESOLUTION

San Juan, Puerto Rico, May 3, 1984

In regards to the documents filed by the appellee party Utility Consulting Services, Inc. dated April 17 and 23, 1984, respectively, "Motion for Reconsideration of Denial of Request to Maintain the Order" and "Motion Seeking to Vacate Judgment", not granted.

So was agreed by the Court and so the General Clerk certifies. The Presiding Judge, Mr. Trias Monge and Associate Judge Mr. Negron Garcia did not participate. Associate Judge, Mr. Rebollo Lopez would reconsider.

Lady Alfonso de Cumpiano
General Clerk

APPENDIX D

Unofficial Translation

[Filed June 29, 1984]

IN THE

SUPREME COURT OF PUERTO RICO

UTILITY CONSULTING SERVICES, INC.
Plaintiff-Appellee,

v.

CITY OF SAN JUAN, DR. HERNÁN PADILLA
Defendants-Appellants

CASE No. R-83-51
R-83-52

RE: PETITION FOR REVISION

NOTICE OF APPEAL

Notice is hereby given that Utility Consulting Services, Inc., Plaintiff-Appellee in the above-captioned case, hereby appeals to the Supreme Court of the United States from this Honorable Court's decision of February 14, 1984, and from its denial of timely motions for reconsideration on March 19, 1984, and May 3, 1984.

This appeal is taken under the provisions of 28 U.S.C. § 1258(2).

San Juan, Puerto Rico, June 28, 1984.

Respectfully Submitted

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